

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF MISSISSIPPI
EASTERN DIVISION

THE NORTH RIVER INSURANCE COMPANY

PLAINTIFF

vs.

Civil Action No. 1:92cv366-D-D

M.M. WINKLER AND ASSOCIATES,
a partnership, WILLIAM MORGAN,
OKEE MCDONALD, PATSY MCCREIGHT
and BRUNO DEODATI

DEFENDANTS

MEMORANDUM OPINION

This matter is before the undersigned on motions of both the plaintiff and defendants M.M. Winkler and Associates, William Morgan, and Okee McDonald. This is an action by the plaintiff North River Insurance Company for a declaratory judgment concerning the rights and liabilities of the parties under a policy of insurance issued by the plaintiff. The plaintiff has moved for summary judgment and the beforementioned defendants have moved for partial summary judgment. Finding that there exist genuine issues of material fact and that the plaintiff is partially entitled to judgment as a matter of law, the court grants the plaintiff's motion for summary judgment in part and denies it in part, and grants the defendants' motion for partial summary judgment in part and denies it in part.

I. FACTUAL BACKGROUND

In 1992, M. M. Winkler and Associates was a partnership of accountants comprised of defendants William Morgan, Okee McDonald and Patsy McCreight. Defendant Bruno Deodati was a client of the partnership, and defendant Patsy McCreight was primarily

responsible for handling Mr. Deodati's accounts. Deodati regularly traveled outside of the United States, and maintained a substantial amount of his money in certificates of deposit (hereinafter CD's) and savings accounts in American banks. Deodati's extended absences from the United States made it difficult to "roll-over" his CD's to ensure his financial protection with banks utilizing the Federal Deposit Insurance Corporation. On June 18, 1985, Deodati executed an authorization giving M. M. Winkler the power to redeem and purchase CD's for Deodati, to ensure that there existed sufficient F.D.I.C. insurance to cover his funds. Over a period of time, McCreight used this authorization to improperly withdraw about \$142,000.00 of Deodati's funds and deposit them into her personal accounts. McCreight covered her tracks by creating false financial reports and tax returns which inaccurately reflected Deodati's financial status.

Discrepancies in Deodati's account were noted by the office manager of M. M. Winkler and Associates, and then brought to the attention of Morgan and McDonald. After an investigation into the discrepancies which revealed McCreight's actions, Morgan informed Deodati. McCreight was then expelled from M. M. Winkler and Associates. Deodati subsequently filed suit against M. M. Winkler, Bill Morgan, Okee McDonald and Patsy McCreight in the Circuit Court of Lee County, Mississippi. Partial summary judgment was entered by that court in favor of Deodati, and against those defendants, for the amount of \$199,051.25.

North River Insurance issued a professional liability policy

to M.M. Winkler which covered the relevant time periods of McCreight's actions. M. M. Winkler made demand upon North River to pay the claim asserted by Deodati, and North River disputed their liability to pay under the policy. In order to resolve the dispute as to its liability, North River filed this Declaratory Judgment action.

II. DISCUSSION

A. SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. F.R.C.P. 56(c). The party seeking summary judgment carries the burden of demonstrating that there is an absence of evidence to support the non-moving party's case. Celotex Corp. v. Catrett, 477 U.S. 317, 325, 106 S. Ct. 2548, 2553, 91 L.Ed.2d 265 (1986). After a proper motion for summary judgment is made, the non-movant must set forth specific facts showing that there is a genuine issue for trial. Hanks v. Transcontinental Gas Pipe Line Corp., 953 F.2d 996, 997 (5th Cir. 1992). If the non-movant sets forth specific facts in support of allegations essential to his claim, a genuine issue is presented. Celotex, 477 U.S. at 327, 106 S.Ct. at 2554. "Where the record, taken as a whole, could not lead a rational trier of fact to find for the non-moving party, there is no genuine issue for trial." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574,

587, 106 S. Ct. 1348, 89 L.Ed.2d 538 (1986); Federal Sav. and Loan Ins. v. Krajl, 968 F.2d 500, 503 (5th Cir. 1992). The facts are reviewed drawing all reasonable inferences in favor of the non-moving party. King v. Chide, 974 F.2d 653, 656 (5th Cir. 1992).

In this case, the parties appear to be in consensus that there are no genuine issues of material fact in this case. The parties' agreement concerning genuine issues of material fact, however, does not necessarily preclude their existence. If there are none, this court must determine which party is entitled to judgement as a matter of law.

B. IS M.M.WINKLER'S LIABILITY FOR THE ACTIONS OF PATSY MCCREIGHT INITIALLY COVERED BY THE PROFESSIONAL LIABILITY POLICY ISSUED BY NORTH RIVER?

The threshold question to be determined by this court is whether the professional liability insurance policy issued by North River to defendant M. M. Winkler and Associates provides coverage for the amounts owed to Deodati for the actions of Patsy McCreight. If this court finds that there is no coverage, the inquiry is ended. If however, the scope of the policy initially appears to provide coverage, then this court must determine if any exclusions apply. In determining the rights of the parties under this contract of insurance, this court must rely upon Mississippi substantive law of contracts and insurance.

Insurance contracts, like all other contracts, are to be construed exactly as written when its terms are clear and unambiguous. Davenport v. St. Paul Fire and Marine Ins. Co., 978 F.2d 927, 930 (5th Cir. 1992); Foreman v. Continental Casualty Co.,

770 F.2d 487, 489 (5th Cir. 1985). The mere fact that a policy language requires interpretation does not make the contract ambiguous. Employer's Insurance of Wassau v. Trotter Towing Corp., 834 F.2d 1206, 1210 (5th Cir. 1988). However, if ambiguities exist, they are to be strictly construed against the drafter, which is normally the insurance company. Nichols v. Shelter Life Insurance Co., 923 F.2d 1158, 1162 (5th Cir. 1991); Merchants Co. v. American Motorists Ins. Co., 794 F.Supp. 611, 618 (S.D. Miss. 1991); Lowery v. Guaranty Bank and Trust Co., 592 So.2d 79, 82 (Miss. 1991). In determining their meaning, words are to be given their everyday meanings, and not hypertechnical or esoteric definitions. McFarland v. Utica Fire Ins. Co. of Onieda County, 814 F.Supp 518, 525 (S.D. Miss. 1992). With this direction, the court now turns to the language of the policy at hand.

1. COVERAGE FOR THE PERFORMANCE OF PROFESSIONAL ACCOUNTING SERVICES

The professional liability policy issued by North River to M. M. Winkler and Associates provides that:

The Company will pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as compensatory damages caused by acts, errors or omissions in the Insured's performance of professional accounting services for others . . .

Several facts are not in dispute here. The defendants (with the exception of defendant Deodati) were properly covered by this policy at the time of McCreight's actions. These same defendants are now legally obligated to pay compensatory damages to defendant Deodati. In order to determine whether the policy extends coverage to the actions of Patsy McCreight under this provision, this court

must determine whether the legal obligation of these defendants for damages was "caused by acts, errors or omissions in the Insured's performance of professional accounting services for others . . ."

Highly relevant to this determination is the meaning of the phrase "professional accounting services." The policy provides a definition of "professional accounting services," explaining that:

The term "professional accounting services" shall mean services performed or advices given by the insured for fee or otherwise in the conduct of the Insured's practice as an accountant, including without limitation, duties performed or advices given in relation to matters of taxation and duties performed or advices given in connection with the American Institute of Certified Public Accountants or any state society of Certified Public Accountants.

The Mississippi Supreme Court has addressed the definition of "professional services" in the context of a professional liability policy on a prior occasion. Shelton v. American Insurance Company, 507 So.2d 894, 896 (Miss. 1987). The language used in the policy at issue in Shelton is similar to the one at hand, and provided coverage for an "act, error or omission in rendering or failing to render professional services." Shelton, 507 So.2d at 895. The definition of "professional services" in that policy was in essence "services . . . performed by the insured . . . for the insured's activities as a like underwriter . . ." The court in Shelton appears to have adopted a definition from other jurisdictions, determining that "professional services" involve the application of special skill, knowledge and education arising out of a vocation, calling, occupation or employment. Id. at 896. The Mississippi court also quoted from a noted treatise on the subject:

A "professional" act or service within a malpractice policy is one rising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor or skill which is predominately mental or intellectual, rather than physical or manual . . .

An errors or omissions policy is professional liability insurance providing a specialized and limited type of coverage as compared to comprehensive insurance, it is designed to insure members of a particular professional group from the liability arising out of a special risk such as negligence, omissions, mistakes and errors inherent in the practice of the profession.

Id. (quoting 7A J.A. Appleman, Insurance Law and Practice, § 4504.01, at 309-10 (Berdal ed. 1979)).

From the Shelton decision, this court takes two points to determine what is covered under the policy in the present case: 1) to be classified as a "professional service," the purpose furthered by the act, error or omission must be one that involves the application of special skill, knowledge and education arising out of the particular vocation, calling, occupation or employment, and 2) the act, error or omission involved must be one of a special risk inherent in that profession. Before using these two directives, the court must determine what acts, errors or omissions created the liability now facing the Winkler-associated defendants. There appears to be more than one "act" which gives rise to liability here. Obviously, McCreight's action of transferring money from Deodati's accounts to her own would be only one type of "act" involved here. McCreight transferred funds on two separate occasions, moving funds totalling \$142,000.00. However, she did more than merely transfer funds to her own account, because she also falsified accounting reports and tax returns to cover up the

transfers. McCreight's actions in transferring funds arose from the authorization issued to M. M. Winkler which gave the requisite power to access the financial accounts of Deodati and control funds therein. Plaintiff argues strenuously that the acts of transferring funds for a client is not a "professional accounting service," and therefore liabilities arising from those acts are not covered. The plaintiff takes its reading of the policy too far. The policy states that it covers acts "in the performance of" professional accounting services. Using plaintiff's reasoning, the creation of a false tax return by an accountant would not give rise to liability of the policy because the act of typing inaccurate numbers on a form is not itself a "professional accounting service."

The court in Shelton noted that the policy in that case did not cover the Insured because the liabilities arose from the relationship and dealings between the insured and his employees, and not from the relationship between the insured and his clients. Shelton, 507 So.2d at 896. In the case at hand, however, the acts occurred within the dealings and professional accountant-client relationship of McCreight and M. M. Winkler and Associates. The authority to transfer funds was for the purpose of protecting those funds from the risk of not being insured. The purpose of protecting those funds in such a manner is accounting-related, and requires the application of special knowledge arising out of the profession of accounting. It is important to remember that the **purpose** of the act is what requires application of special skill,

knowledge and education, not the very **act** itself. In this case, the acts of transferring the funds are so interrelated with their professional relationship that they can be said to have occurred in the performance of professional accounting services.

While the acts can be said to have occurred within the gamut of the performance of professional accounting services, this alone will not permit the application of coverage. It is not apparent to this court that the risk of having an accountant embezzle funds from a client in this manner is a risk that is "inherent" in the profession of accounting. Damages incurred from the wrongful transfer of funds, ostensibly in the amount of \$142,000.00, are not covered by this policy.

Although damages for the actual conversion of funds are not covered by the policy, damages which arise from the creation of erroneous financial statements and reports are another matter entirely. It seems beyond question that the creation of such reports is an act within performance of professional accounting services, and that damages arising from such acts is an "inherent" risk of the profession of accounting.

The court cannot decide at this time what amount beyond the amount of funds initially converted (\$142,000.00) is precluded from coverage, and what amount of the liability, if any, is in fact covered as arising from the creation of financial statements and reports. The determination of these amounts would be a question of fact for the trier of fact to decide. Thus far, any amount of damage caused by the false reports appears be covered by this

policy.

2. COVERAGE UNDER THE TRUSTEE ENDORSEMENT

The defendants also argue that the policy provides coverage for all of the Winkler-defendants' liabilities by virtue of the "Trustee Endorsement." This endorsement provides in relevant part that coverage will apply for any acts, omissions or errors of the insured's performance as a trustee. They assert that due to the relationship McCreight had with Deodati, and by virtue of the authorization, McCreight stood as a trustee over Deodati's funds. At first blush, this approach appears meritorious. McCreight can be said to be the trustee of a constructive trust created by the conversion of the funds. See Champion Intern. Corp. v. First National Bank of Jackson, 642 F.Supp. 237 (S.D. Miss. 1986); Planter's Bank & Trust Co. v. Sklar, 555 So.2d 1024 (Miss. 1990). Likewise, McCreight could be considered a trustee under a less-than-strict definition of the term. Black's Law Dictionary 1684 (noting that a broad definition of "trustee" would encompass anyone standing in a fiduciary or confidential relation to another). However, this argument must fail. While some interpretations of the word "trustee" would allow for the defendants' assertions to pass, this court must give the word its common, everyday meaning. McFarland, 814 F.Supp at 518. Likewise, the rest of the document must be considered, for the words involved cannot be interpreted in a vacuum. It is apparent both from a reading of the entire policy and from the everyday definition of the term that "trustee" as used in the present case was meant to encompass only the insured as

trustee of an express trust. The authorization executed by Deodati in this case is insufficient to create an express trust because there was no separation of the legal and equitable interests involved. 76 Am.Jur.2d Trusts § 1 (1992). Further, it does not appear that Deodati intended to create a trust when he signed the authorization. See Norman v. Burnett, 25 Miss. 183 (1852).

C. POLICY EXCLUSIONS

Now that the court has determined that a portion of the liabilities of the Winkler-defendants may in fact be covered by the basic coverage provisions of the policy, the court must determine if any of the contractual exclusions contained in the policy would necessarily prevent recovery.

1. EXCLUSION "D" OF THE POLICY

Exclusion "D" of the policy precludes coverage when the asserted claim arises out of any "dishonest, fraudulent, criminal or malicious act or omission of the insured." It is not disputed that Defendant McCreight committed a dishonest and fraudulent act by converting Deodati's funds and creating false accountancy documents. Therefore, she is not entitled to any coverage under the policy. This exclusion is not imputed to any of the remaining defendants, however, for two reasons. First, the policy itself provides that Exclusion "D" will not apply to invalidate coverage for any insured "who did not act with knowledge or consent in the matter to which the exclusion applies." It also does not seem disputed that defendants Morgan and McDonald were entirely ignorant of these deplorable actions by McCreight at the time they were

taken. Further, this policy does not contain a non-severability clause. As a matter of Mississippi law, in the absence of such a clause, innocent partners may recover under the policy for the deliberate wrongful acts of the other insured. McGory v. Allstate Insurance Co., 527 So.2d 632, 638 (Miss. 1988).

2. EXCLUSION "C" OF THE POLICY

Also in dispute among the parties is the application of exclusion "C" of the policy, which provides that coverage will be denied:

to any claim arising out of any act, error or omission occurring prior to the effective date of this policy if there is other insurance applicable, or the insured at the effective date knew or could have reasonably foreseen that such act, error or omission might be expected to be the basis of claim or suit.

Plaintiff contends that McCreight obviously knew of her wrongful actions prior to the effective date of the applicable policy, and that she could have reasonably foreseen that those actions would be the basis of a claim or suit by Deodati. The court agrees, but McCreight is already precluded from recovery under Exclusion "D" of the policy. Plaintiff further seeks to impute McCreight's knowledge to Morgan and McDonald, her partners at the time, and preclude their recovery as well. In support of this contention, plaintiff directs this court to a provision of the Mississippi Code which pertains to the imputation of knowledge among partners:

Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have

communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

Miss. Code Ann. § 79-12-23 (1989). Looking at this provision alone might lead the court to agree with the plaintiff in this matter. However, the plaintiff's interpretation of it is incongruous with the idea espoused by the Mississippi Supreme Court in McGory:

[A]bsent a insurance policy clause excluding coverage to . . . co-insureds because of the deliberate wrongful act of one co-insured (non-severability clauses), the innocent . . . **business partner** insured can recover on the policy.

McGory, 527 So.2d at 638 (emphasis added). Plaintiff's approach to imputed knowledge would circumvent the express intent of the Mississippi Supreme Court by doing an end-around McGory. An insurance company could include seemingly fair provisions akin to Exclusion "C", avoid having to include a non-severability clause in their professional liability policies, and nonetheless avoid payment to an insured innocent partner who is only vicariously liable. It is this court's opinion that to interpret this policy consistently with Mississippi law, the knowledge contemplated by the insurance policy language of Exclusion "C" cannot encompass imputed knowledge as provided for under Miss. Code Ann. § 79-12-23.

Whether Morgan and McDonald had sufficient knowledge independent of that imputed by law to render them unable to recover under the policy is a separate issue. Plaintiff contends that Morgan and McDonald were in possession of sufficient facts to either know or to have reasonably foreseen that a claim or suit

would be filed. While the parties may not disagree with what facts were available to Morgan and McDonald at the time, the reasonableness of their beliefs is a question of fact, which must be determined by a trier of fact. As such, this issue is inappropriate for summary judgment.

D. RESCISSION OF THE POLICY BASED UPON MISREPRESENTATIONS IN THE RENEWAL APPLICATION

Finally, plaintiff claims that it should not have to pay on this policy of insurance because it is capable of rescinding the contract based on misrepresentations made in the application for renewal of the policy. See, e.g., Home Life Insurance Co. v. Madere, 101 F.2d 292, 294 (5th Cir. 1939); Massachusetts Mutual Life Ins. Co. v. Nicholson, 775 F.Supp. 954, 959 (N.D. Miss. 1991). The insurer's right to rescind arises only where the misrepresentations are material, that is, "if knowledge of the true facts would have influenced a prudent insurer in whether to accept the risk." Massachusetts Mutual, 775 F.Supp. at 959. It is irrelevant whether the misrepresentations were intentional or made in good faith. Id. at 961; Dukes v. South Carolina Ins. Co., 590 F.Supp. 1166, 1169 (S.D. Miss. 1984). Regardless, the insurer has the burden of establishing, by clear and convincing evidence, the existence of a factual misstatement and its materiality. Gardner v. Wilkinson, 643 F.2d 1135, 1136 n.3 (5th Cir. 1981); Pedersen v. Chrysler Life Ins. Co., 677 F.Supp. 472, 474 (N.D. Miss. 1988). In order to determine if summary judgment is appropriate here, this court must determine if North River has met its burden in this regard.

As to the existence of a factual misstatement, North River asserts that the insureds responded "No" to the question "are there facts or circumstances which may result in a claim being made against the Firm, its predecessors, or past owners or employees?" North River further asserts, and this court agrees, that it had provided clear and convincing evidence that this answer is patently false to the extent it pertains to McCreight. At the time she signed this document, McCreight was well aware of her actions and the potential for suit.

North River would have this court render this provision non-severable and bind the remaining defendants as well as McCreight. Also, North River contends that Morgan and McDonald were in possession of sufficient facts that they also made a misrepresentation by subscribing to this statement. The issues of severability and the knowledge possessed by Morgan and McDonald have already been addressed in this case in a very similar context, and this court sees nothing that would warrant a departure from its prior reasoning. In the absence of a non-severability clause, the policy will be treated as severable. Whether Morgan and McDonald were in possession of sufficient facts to make this a material misrepresentation on their part is a question of fact. Summary judgment cannot be rendered on the issue of rescission.

E. THE BAD FAITH CLAIM

On a separate claim, plaintiff urges this court to grant summary judgment on the issue of the claim of bad faith refusal. Considering the current posture of the case, this court is of the

opinion that sufficient questions of material fact exist to preclude a grant of summary judgment on this claim.

III. CONCLUSION

Based on the foregoing, it is the opinion of this court that North River is not liable under this policy of insurance for any amounts of damage caused exclusively by the misappropriation of monies by McCreight. This amount appears to be at least \$142,000.00, but findings of fact may reveal that the amount is larger. However, any damages caused by McCreight's creation of false reports and tax documents for Deodati are encompassed by the scope of this policy. That amount is unclear to this court, and a finder of fact must determine the extent of any such damages. Several genuine issues of material fact remain in this case, and are sufficient to preclude the grant of a judgment as a matter of law on the other issues raised by the parties in their motions.

A separate order in accordance with this opinion shall issue this day.

THIS _____ day of October, 1994.

United States District Judge

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M.M. WINKLER AND ASSOCIATES,
a partnership, WILLIAM MORGAN,
OKEE MCDONALD, PATSY MCCREIGHT
and BRUNO DEODATI

DEFENDANTS

ORDER

Pursuant to a memorandum opinion issued this day, it is hereby
ORDERED that:

1) the plaintiff's motion for summary judgment is GRANTED IN PART and DENIED IN PART as to the defendants M.M. Winkler and Associates, William Morgan, Okee McDonald and Bruno Deodati. The motion is granted only to the extent that at least \$142,000.00 of the claim on the policy is not covered under the scope of the policy of insurance at issue in this case. All other aspects of the motion are denied.

2) the plaintiff's motion for summary judgment is GRANTED as to defendant Patsy McCreight.

3) the defendants' motion for partial summary judgment is GRANTED IN PART and DENIED IN PART. The motion is granted to the extent that there exists coverage under the policy for any damages resulting from the creation of false accounting and tax documents by McCreight. All other aspects of the motion are denied.

All memoranda, depositions, affidavits and other matters

considered by this court in rendering the disposition of the parties' motions for summary judgment are hereby incorporated and made a part of the record in this cause.

United States District Judge